# Entrepreneurship

**Unit 4: Utilizing Financial Documents** (KEY)

Student: ________________________________ Date: ____________ Period: _______

| DECA Business Plan Format |
|---|
| **Section I:** Executive Summary<br>**Section II:** Analysis of Business Situation<br>Rationale and marketing research, Description of Business, Self-analysis, Analysis of the business opportunity, customer and location, and Proposed organization<br>**Section III:** Marketing and Promotional Plan<br><br>☞ **Section IV:** Financing Plan<br>Income Statements, Amortization, and Return on Investment |

## Section IV: Projecting Cash Flow for Business

**1. A new business owner must be able to:**

- *Estimate Start-up Costs, Costs of Goods Sold (COGS), and Operating Expenses*
- *Calculate Gross Income and Net Income*

All of these items are found on an Income Statement–the final section of the business plan

**2. An Income Statement is also known as a:** _____________________________________

Income Statement Definition: *Summary of a company's profit or loss during any one given period of time (month, quarter, year)*

**3. What are the differences between <u>fixed</u> and <u>variable</u> expenses?**

- Fixed: *Expenses that do NOT change with the number of units sold or produced.*
- Variable: *Expenses that DO change with the number of units sold or produced.*

**4. Start-up Costs**

- The *<u>one time only</u>* expenses paid to establish a business. Many entrepreneurs have to *<u>borrow</u>* the money (friends, family, savings, partners, private investors, etc)
- Common costs include:
  - ✔ *Equipment and supplies*
  - ✔ *Furniture and fixtures*
  - ✔ *Vehicles*
  - ✔ *Remodeling, electrical and plumbing*
  - ✔ *Legal and accounting fees*
  - ✔ *Licensing fees*

**5. Costs of Goods Sold (COGS)**

- *The cost for the inventory to be sold in a business.*
- Service-only businesses *do not* have this type of expense.

**6. Operating Expenses are expenses necessary to *operate* a business.**

Includes:

- ✔ *Salaries*
- ✔ *Insurance*
- ✔ *Lease*
- ✔ *Office Supplies*
- ✔ *Advertising*
- ✔ *Utilities, phone, internet, etc.*

**7. Gross & Net Income**

- Gross Income: *Total income minus COGS*

  Revenue – COGS = Gross Income (Gross Profit)
- Net Income: *Gross Income minus operating expenses*

  Gross Profit – Expenses = Net Income (or loss)

  ☞ These figures are *pre-tax*. The taxes you pay are calculated using the Net Income amount.

**8. Break-even Point**

- The *volume of sales* that must be made to cover all the expenses of the business.

**Your business' fixed costs are $40,000 a year. Your selling price is $3.50 per unit. Your variable cost is 95¢ per unit. How many units must you sell to break even?**

**9. A Balance Sheet is a:** *report of the final balances of all assets, liabilities, and owner's equity at the end of a period.*

**10. What equation is the foundation of a Balance Sheet?** *Assets* = *Liabilities* + *Equity*

- **Assets:** *Represent things of value that a person or company owns and has in its possession or something that will be received and can be measured objectively.*

- **Liabilities:** *What a person or company owes to others-- creditors, suppliers, tax authorities, employees etc. They are obligations that must be paid under certain conditions and time frames.*

- **Equity:** *A company's equity represents retained earnings and funds contributed by its shareholders, who accept the uncertainty that comes with ownership risk in exchange for what they hope will be a good return on their investment. On an individual's balance sheet, it would be called Net Worth (as in the example).*

**11. What parts of the Balance Sheet must equal each other?** *Assets* = *Liabilities* + *Equity*

## Section IV: Identifying Sources of Capital ($)

**12. Define Collateral:** *Owning something that can be used as security in the form of assets that you pledge to a lender. If you don't pay your loan, the lender can seize the asset (i.e., car, home)*

**13. Identifying Sources of Capital**

- Equity Capital: *Cash raised for a business in exchange for an ownership stake in the business.*
- Equity: *Ownership in a business*

**14. Forms of Equity Financing**

✔ *Friends and family*

✔ *Private investors*

✔ *Partners*

✔ *Venture capitalists*

✔ *Funding, grants or subsidies from state*

**15. The 5 C's of Credit to Qualify for a Loan**

- Character: *A borrower's reputation, experience, and ethical values*
- Capacity: *Ability to repay loan. Based on incoming and outgoing-cash flow*
- Capital: *Money to operate a business*
  - ☞ **The net worth of a business**–the amount by which the assets of the business *exceeds* the liabilities
- Collateral: *Security in the form of assets you pledge to a lender*
- Conditions: *Conditions of the environment in which the business operates*
  - ☞ **Lenders consider:**
    - ✔ *Economic conditions*
    - ✔ *Potential for growth*
    - ✔ *Amount of competition*
    - ✔ *Location*
    - ✔ *Form of ownership*

☞ Some lenders will require certain types of *insurance coverage* to limit their risk

**16. Obtaining a Loan**

- Lenders that do not want an equity stake in your company, but are willing to loan you money for your business, will have you pay *interest* on the amount borrowed.

- Interest: *The amount paid to "use" money for a period of time.*
  - ✔ The original amount lent is called the *principal*
  - ✔ The percentage of the principal which must be paid *annually* as interest is called the interest rate.

## Section IV: Calculating Interest

**17. What is the formula for Interest?**

*Principal x Interest Rate x Time = Interest* (PRT = I)

**18. How much must be repaid for a loan with the following terms?**

Principal (P) = $50,000
Interest Rate (R) = 8%
Time (T) = 5 years

*$50,000 x .08 = $4,000 interest/year*
*$4,000 x 5 = $20,000 total interest*
*$50,000+ $20,000 = $70,000 total to repay*

## Section IV: Calculating Monthly Payment

**19. Define Amortization:** *Calculating fixed monthly payments over the life of the loan.*

**20. Calculate the monthly payment for the loan in questions #14.**

*5 years = 60 months*
*$70,000 ÷ 60 = $1,166.67 (monthly payment)*

## Section IV: Calculating Return on Investment

**21. ROI means *Return on Investment.***

- A *comparison* of the money earned (or lost) on an investment to the amount of money invested.
- You need to determine your potential ROI *before* you start your business. If the return is too low, *don't waste your time* with this business.
- Time is *money*

**22. Calculating Return on Investment (ROI)**

- Smart investors look for returns of *10% or higher* from a business.
- What is the ROI on an:

  $80,000 investment
  10% yearly return (ROI)

  *$80,000 x .10 = $8,000 ROI (annual Net Profit)*

**23. Remember: Your *MONEY* should work hard for you; not *YOU* work hard for your money.**